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Policy Brief: Urban Village Fund (*Dana Kelurahan*) Allocation, Formulation, and Utilisation

Background

In the context of government decentralisation and regional autonomy,[1] the central government initiated a policy on a financial equalisation fund between the central and regional governments. The fund is implemented through financial transfers from the central government to the provincial, district/municipal, and village governments. These are now known as regional transfer funds.

Article 1, Paragraph 3 of the Law No.33 of 2004 on Financial Equalisation between the Central and Regional Governments defines a governmental financing system within a unified state that covers the disbursement of finances between the central and regional governments as well as equal distribution between regions in a proportional, democratic, fair, and transparent manner. It takes account of the region's potential, conditions, and needs, together with the obligation, authority, and means of enforcing such authority, including its financial management and monitoring.

The regulation has several objectives to enhance the administration of public finances. These include: (i) improving regional fiscal capacity in government administration; (ii) minimising inequality in the source of government funding between the central and regional governments; (iii) reducing the gap in funding between regional governments; (iv) improving both the quantity and quality of public services in the regions and reducing the public services gap between regions; (v) prioritising the provision of basic services in disadvantaged, outlying, remote, advanced, and post-disaster regions; (vi) promoting economic growth through the development of basic infrastructure; (vii) improving the efficiency, effectiveness, transparency, and accountability of regional financial management; (viii) improving the quality of allocations to the regions by paying attention to accountability and transparency; and (ix) improving the monitoring and evaluation of funds transfers to the regions.

There has been a fundamental change in local government administration, especially at the village level since the introduction of Law No. 6/2019 on Villages. One of the consequences of this law is the policy on regional fund transfers to villages under Articles 72 and 78, Paragraph 1. Under this regulation, the Village Fund (*Dana Desa*: DD) is a source of village revenues from the state budget (Anggaran Pendapatan dan Belanja Nasional: APBN) and is used to develop the villages with the aim of improving villagers' welfare by improving their quality of life and alleviating poverty by fulfilling basic needs, building village infrastructure and sustainable development of local economic potential.

Between 2014 and 2017, the volume of funds transferred to villages was at least Rp 187 trillion. The size of the DD budget sourced from the APBN is set at 10 percent of the equalisation funds received by districts/municipalities in the regional budget (Anggaran Pendapatan dan Belanja Daerah: APBD) after deduction of the Special Allocation

[1] Law No. 22/1999 on Regional Governments and Law No. 25/1999 on Financial Balance between Central and Regional Government and its Amendment.

Fund (Dana Alokasi Khusus: DAK) in accordance with Article 72, Paragraph 4. Nevertheless, this total allocation was undertaken in stages in line with the financial capacity of the APBN (Government Regulation No. 22/2015). The DD allocation in 2015 was Rp 20.766 trillion, which was increased to Rp 46.982 trillion in 2016, and then to Rp 60 trillion in 2017 and 2018. In 2019, the budget cap planned for the DD was around Rp 70 trillion.

The rather large volume of village funding over the last four years has caused jealousy among district/ municipality governments, especially those that have urban villages as the smallest administration unit in their region. Since 2018, the Association of Indonesian Municipalities (Apeksi) has suggested that villages should not be the only ones receiving funds directly from APBN given through the DD, but that an additional budget from the central government needs to be allocated to urban villages. This suggestion is based on the consideration that urban villages have budget problems–for example, in dealing with poverty, inequality, and unemployment. To date, other than relying on the APBD, the development of urban villages (*kelurahan*) has been reliant on DAK, although the amount is not as large as the DD. In comparison with villages, urban village financing resources are still limited. This budget constraint led Apeksi to suggest that there should be other funding sources, just as the villages receiving village funds.

Urban villages are facing development problems that are just as complex as villages, albeit different in scale. One of the development problem indicators is, among others, the relatively high unemployment rate, especially of unemployed persons with a poor educational background. In addition, municipalities–particularly within urban village administrative regions–are dealing with other development issues where the expenditure gap between groups is relatively high compared to village administrative areas. On the other hand, the main source of revenues for urban villages is from the district/municipality APBD, so they are far more limited in comparison with village administrative areas.

Objectives and Basic Principles of Urban Village Fund (*Dana Kelurahan*: DK)

The main objective of transferring funds to regions is to enhance the prosperity and equity of urban village development through: (i) improving public services; (ii) boosting the economy; (iii) overcoming inequity in development between urban villages; and (iv) strengthening the community. The objective of transferring DK is to provide an incentive to urban villages to accelerate their development and to narrow the financing/budgeting gap between village and urban village administrations. In this way, it is expected that both villages and urban villages will experience equitable development.

Table 1: Comparison Between Village and Urban Village Administrative Area

No.	Description	Village	Urban Village
1	Leader	Head of Village (*Kades*)	Head of Urban Village (Lurah)
2	Position Status	Leader of this area/village	District/municipality government official working at the specified urban village
3	Employment Status	Non-civil servant	Civil Servant
4	Appointment process	Chosen by the villagers through village election (PILKADES)	Appointed by the Regent/Mayor
5	Term of Office	Five years and can be elected again for another period	Unlimited and can be aligned with regulation on Civil Servant pension
6	Financing for Development	Fund is sourced from various resources in accordance with the prevailing law	Fund is sourced from APBD

Source: Susenas 2017.

The mechanism to transfer funds to the villages originates with the central government in the APBN. The funds are channeled through the districts that allocate the funds in their APBD. The local governments will then distribute the funds to the villages in their area. In contrast, urban villages receive their funds directly from the municipality administration that is included in the APBD. If an urban village funding allocation is proposed, it will be budgeted in the General Allocation Fund (Dana Alokasi Umum: DAU), which will then be included in the APBD as an earmarked allocation. These urban village funds are allocated in the sub-district budget to be utilised in accordance with the prevailing laws and regulations.

The main objectives of the Urban Village Allocation Fund are: (i) to improve public services; (ii) overcome poverty and inequality; (iii) improve the economy; (iv) develop urban village infrastructure; and (v) empower the community. To date, the Urban Village Special Allocation Fund has allocated an amount of Rp 3 trillion. The principle of equity in DK allocations requires consideration of inter-regional financial capability which can be relatively heterogenous. This principle is then actualised in the Basic Allocation (*Alokasi Dasar*: AD).

Gap Between Village and Urban Village

The Composition of Population and Expenditure

In 2017 the majority of Indonesia's population of 261 million (68.15 percent) lived in villages with 31.85 percent living in urban villages (Table 2). Village administrations comprised 89.79 percent of the 83,477 administrative regions in Indonesia, compared with only 10.17 percent for urban village administrations. On average, there are approximately 9,800 people living in an urban village and 2,300 people in each village.

Nationwide, Indonesian citizens spend an average of Rp 1,036,497 per capita per month. Household expenditure per capita at the urban village level is 70.1 percent higher than that in villages–Rp 1,442,215, compared with Rp 846,873. Expenditure distribution in both villages and urban villages is still dominated by the top 20 percent group, as is the case nationally.

Table 2: Various Social and Economic Indicators at Village and Urban Village Administrative Regions

Description		Administration Status*	
	Total	Urban Village	Village
Total Population	261,090,750	83,160,839	177,929,911
Proportion of the Population	100%	31.85%	68.15%
Number of administration regions**	83,477	8,490	74,957
Proportion of the Regions	100%	10.17%	89.79%
Expenditure per capita/Month	1,036,497	1,442,215	846,873
Inequality			
Expenditure Distribution			
Lowest 40%	17.12	16.34	19.18
Intermediate 40%	36.47	37.28	38.11
Top 20%	46.41	46.38	42.71
Gini coefficient	0.393	0.39963	0.34918

Source: Susenas 2017.
Note: *According to the definition of the Ministry of Home Affairs **Minister of Home Affairs Regulation No. 137/2017 on Code and Data of Government Administration Regions.

It is interesting to note that the rate of inequity (Gini coefficient) at the village is lower (0.34918 percent) than for urban villages (0.39963 percent). The inequity level in urban villages is, therefore, 14 percent higher than village areas. The government should, therefore, give serious attention to the problem of inequity in urban villages through various kinds of development policy interventions in urban village regions.

Open Unemployment Rate

According to data published by Statistics Indonesia (Badan Pusat Statistik: BPS), the Open Unemployment Rate in August 2017 was 5.40 percent (Table 3). In the village area, the open unemployment rate was estimated at 5.28 percent, while for the urban village area it was 5.64 percent–a difference of 0.36 percent.

The unemployment rate among less-educated citizens in urban villages is relatively higher in comparison with village administration regions. In the urban village region, the unemployment rate of those with an educational background lower than a primary school (*sekolah dasar*: SD) graduate/equivalent is higher than village regions. The level of unemployment for graduates of vocational schools (*sekolah menengah kejuruan*: SMK)/equivalent is highest for all educational levels, both in villages (9.0 percent) and urban villages (7.2 percent).

At the village level, the top three unemployment rates are for SMK graduates/equivalent (9.0 percent), followed by Diploma I/II/III at 7.3 percent and from Senior High School (*sekolah menengah atas*: SMA)/ equivalent level at 7.2 percent. For the urban village area, the top three unemployment rates are amongst SMK graduates/equivalent, SMA/equivalent, and Junior High School (*sekolah menengah pertama*: SMP)/equivalent respectively at 7.2 percent, 6.1 percent, and 5.8 percent.

Table 3: Comparison of Unemployment Level by Education Level in Villages and Urban Villages (2017)

Description	Total	Administration Status*	
		Urban Village	Village
Open Unemployment Rate	**5.40**	**5.64**	**5.28**
Did not graduate from Primary School	3.42	4.4	3.2
Graduate of Primary School/Equivalent	4.27	4.2	4.3
Graduate of Junior High School/Equivalent	6.58	5.8	6.9
Graduate of Senior High School/Equivalent	6.71	6.1	7.2
Graduate of Vocational School/Equivalent	8.17	7.2	9.0
Graduate with Diploma I/II/II	6.24	5.5	7.3
Graduate of University (S1/S2/S3)	4.97	4.7	5.3

Source: Susenas 2017.
Note: *According to the definition of the Ministry of Home Affairs.

Village and Urban Village Revenue Sources

According to Article 72, Paragraph (1) of Law No. 6/2014 on Villages, there are seven locally generated revenue sources (Pendapatan Asli Desa: PAD) (Table 4). Three of these are the main sources of village revenues: the DD; Village Fund Allocation (*Alokasi Dana Desa*: ADD); and profit sharing from the district/municipality's Taxes and Retribution Share (PDRD). On the other hand, the urban village only receives financial support from the district/ municipality's APBD. Other than relying on the APBD, the development of urban villages relies on other sources such as the DAK.

Table 4: Village and Urban Village Revenue Sources (2017)

TYPE OF REVENUE	Village*	Urban Village
Regional Own-source Revenue	4.29%	0.00%
Revenue Transfers	95.13%	0.00%
Village Funds from APBN	55.41%	0.00%
Regional Taxes and Retributions Share (minimal 10%)	2.48%	0.00%
Village Fund Allocation from DAU and DBH (minimal 10%)	32.04%	0.00%
Financial Assistance from APBD	5.20%	100%
Grants and Third Party ContributionsI	0.00%	0.00%
Other Legal Revenues	0.05%	0.00%

Source: Village Financial Statistic 2017.

In general, the urban village administration area is spread across almost every province in Indonesia–only in Aceh are there no urban village administration regions (Figure 1). This condition demonstrates that the effort to improve and to have equitable development capacity should be done in every region, whether that is in the villages or urban villages.

Figure 1: Distribution of Urban Village and Village Administration Status (2017)

Source: **Regulation of Ministry of Home Affairs No. 137/2017 on Code and Data of Government Administration Regions.

Development issues in the urban village area are just as complex and as important as in village areas. The initiative to allocate a DK budget transfer under Government Regulation No. 17/2018 on Sub-Districts is quite relevant, although this law is relatively weaker than Law No. 6/2014 on Villages that covers the Village Fund. This allocation is a means to strengthen development funding through additional allocations for development in urban villages.

DK Allocation Initiative

Village Fund Formulation At a Glance

The DD allocation for districts/municipalities and villages comprises the AD and Formula Allocation (*Alokasi Formula:* AF). According to Article 11, Paragraph (1a) of Government Regulation No. 22/2015, a "Basic Allocation" is a minimum allocation from the Village Fund that is received by districts/municipalities based on a certain calculation, including an equal distribution to every village in Indonesia.

The AF is the total Village Fund minus the AD. The AF funds are then distributed to each district/municipality and village taking into account the number of villagers, village poverty rate, village area, and Construction Price Index (*Indeks Kemahalan Konstruksi:* IKK). The AD is 90 percent of the total Village Fund and is distributed equally to every village, while the remaining 10 percent of the Village Fund is the AF.

Until 2018, the formula for adjusting the Village Fund was done in accordance with the mandate from the Law on Villages requiring an equal and fair allocation. The principle of equality is implemented through the AD which is a fixed allocation for each village. The principle of fairness is implemented via the AF which is a variable budget distribution where the condition of each region determines the allocation amount. This variable allocation is highly dependent on four indicators: (i) number of population; (ii) number of poor residents; (iii) area of the region; and (iv) geographical difficulties. Since the 2018 fiscal year, an affirmative allocation component has been added to the Village Fund formulation for disadvantaged and highly disadvantaged regions. The affirmative allocation is part of the allocation based on the principle of fairness, however, with a regional priority approach.

Geographical Difficulty Index (*Indeks Kesulitan Geografi*: IKG) At a Glance

A difference in the quantity and quality of basic facilities and infrastructure (supply-side) is one of the causes of disparities between regions. This disparity provides a comparison between the progress of development in a region and its level of underdevelopment (disadvantage). The IKG is a composite index used to categorise the status of a region's development progress and its disadvantages, specifically for village administration regions.

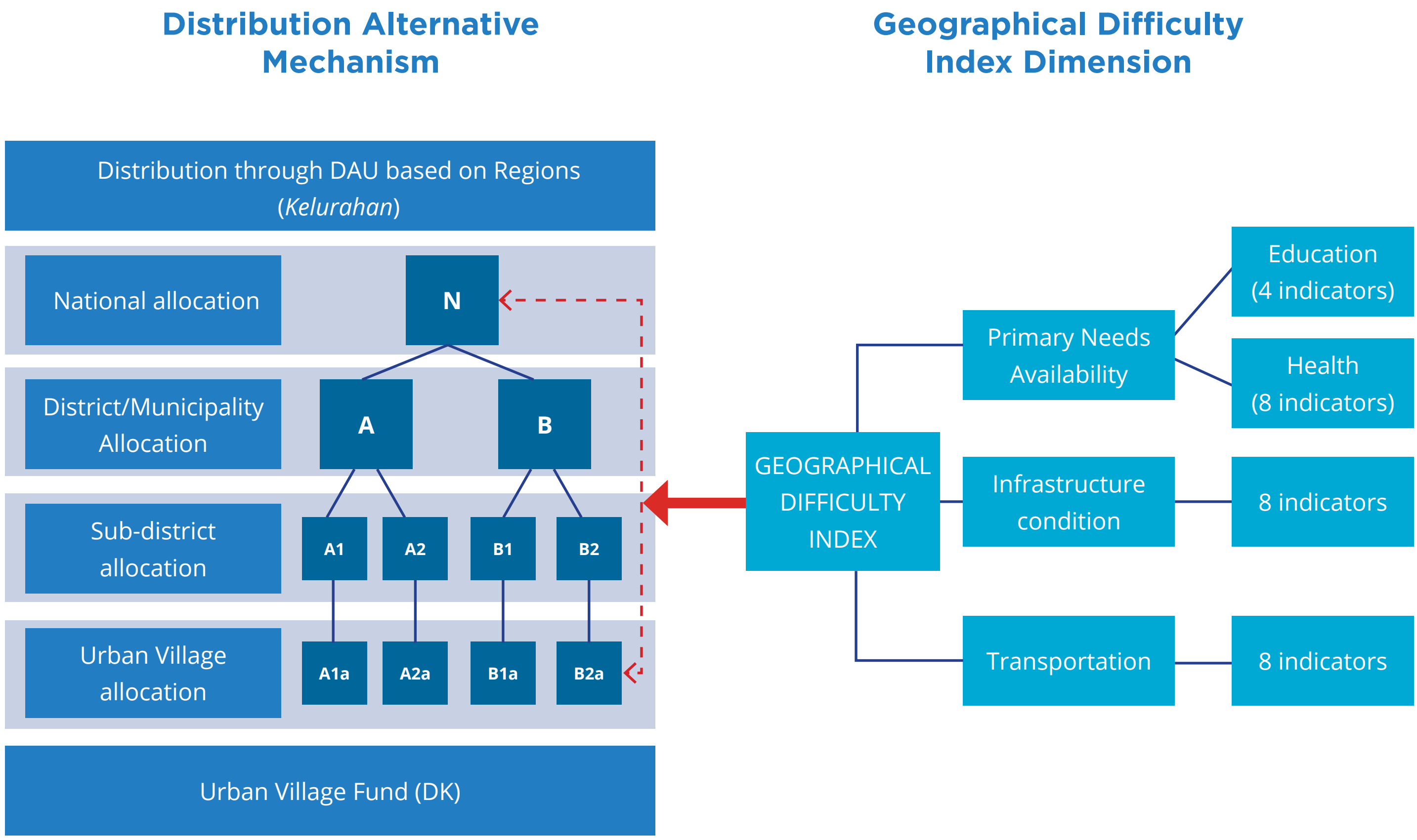
The IKG is compiled based on three dimensions/factors, namely: (i) availability of primary services; (ii) condition of infrastructure; and (iii) accessibility/transportation. The IKG compilation represents the basic needs criteria in an area at the village level and is aligned with the standard stated in Government Regulation No. 60/2014, as amended by Government Regulation No. 22/2015. The IKG composite index is, in principle, not only applied to villages, but the same variable can also be applied in urban village administrative areas.

DK Distribution Initiative

Urban village funds are distributed through the DAU as mandated by the prevailing regulations. Based on Government Regulation No. 17/2018 on Sub-Districts, Article 30, Paragraph 1 states that local government at district/municipality level shall allocate funds in the APBD to improve urban village facilities and infrastructure and to empower urban village communities. The amount of the allocation for each administrative area is determined in accordance with Paragraphs 7 and 8. This states that the budget allocation for a municipality with no villages is that mentioned in Paragraph 1, or a minimum of 5 percent of the APBD after deducting the special allocation fund. For a district that has urban villages and a city with villages, the urban village allocation as mentioned in Paragraph 1 is at least the same as the lowest village fund amount received by villages in a district/municipality.

DK Distribution Proposal

Figure 2: DK Distribution Proposal



DK money is ideally distributed based on the composite index as applied in the DD and DAU. It has been recommended that the allocation for the urban village fund should use the same approach as Village Fund allocation by using the principles of equality and fairness. The proportion for the AD that represents the principle of equality should at least be equal to 70 percent of the total national allocation, while the proportion for the AF–representing the principle of fairness–should constitute at least 30 percent of the total national allocation.

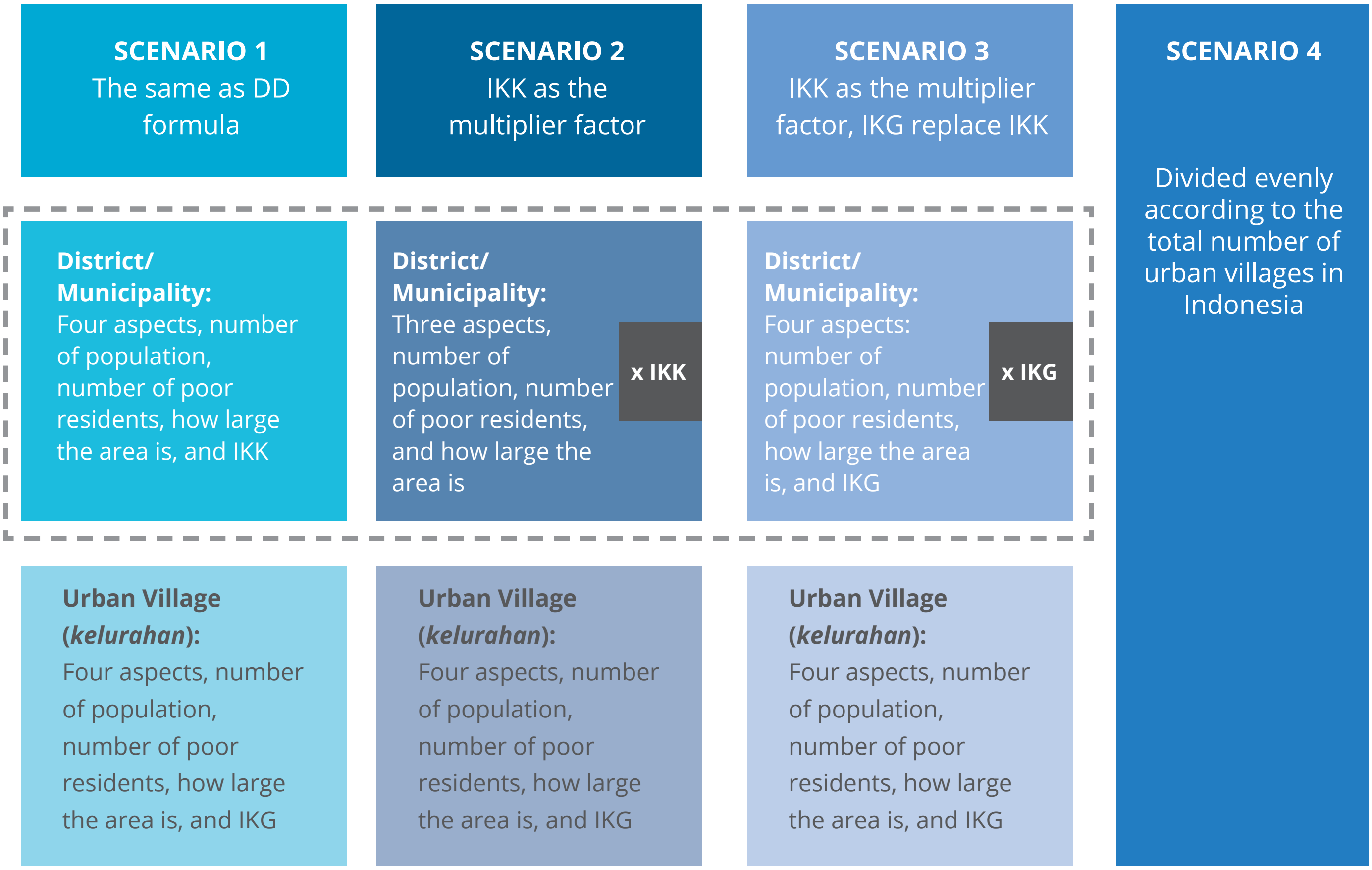
The AD proportion takes into consideration the current DK allocation that is still relatively limited. The ratio between the AD and AF should ideally be 1:1 where the principles of fairness and equality have the same weighting. It is also necessary to develop a composite index as the distribution instrument in the same way that the IKG is used as the means of formulating the Village Fund.

Proposed Scenario for DK Allocation Formulation

There are four scenarios recommended for Urban Village formulation with each scenario adjusted to the budget and socioeconomic condition of a region (Figure 3).

Under Scenario 1, the DK allocation for district/municipality and village is comprised of the AD and AF. The AD is the minimum DK allocation received by a district/municipality based on a defined calculation, including an equal allocation for every urban village across Indonesia. The AF is the residual allocation after deducting the AD from the Total Village Fund. The AF is then distributed to every district/municipality and urban village through the DAU after taking into account: (i) the size of the urban village population; (ii) poverty rate at the urban village; (iii) area of the urban village; and (iv) the IKK at the district/municipality level or the IKG at the urban village level.

Figure 3: Proposed Scenario for DK Formulation



Under Scenario 2, the Village Fund allocation for a district/municipality and urban village consists of the AD and AF. The IKK is used as a multiplier factor for other indicators when determining the AF.

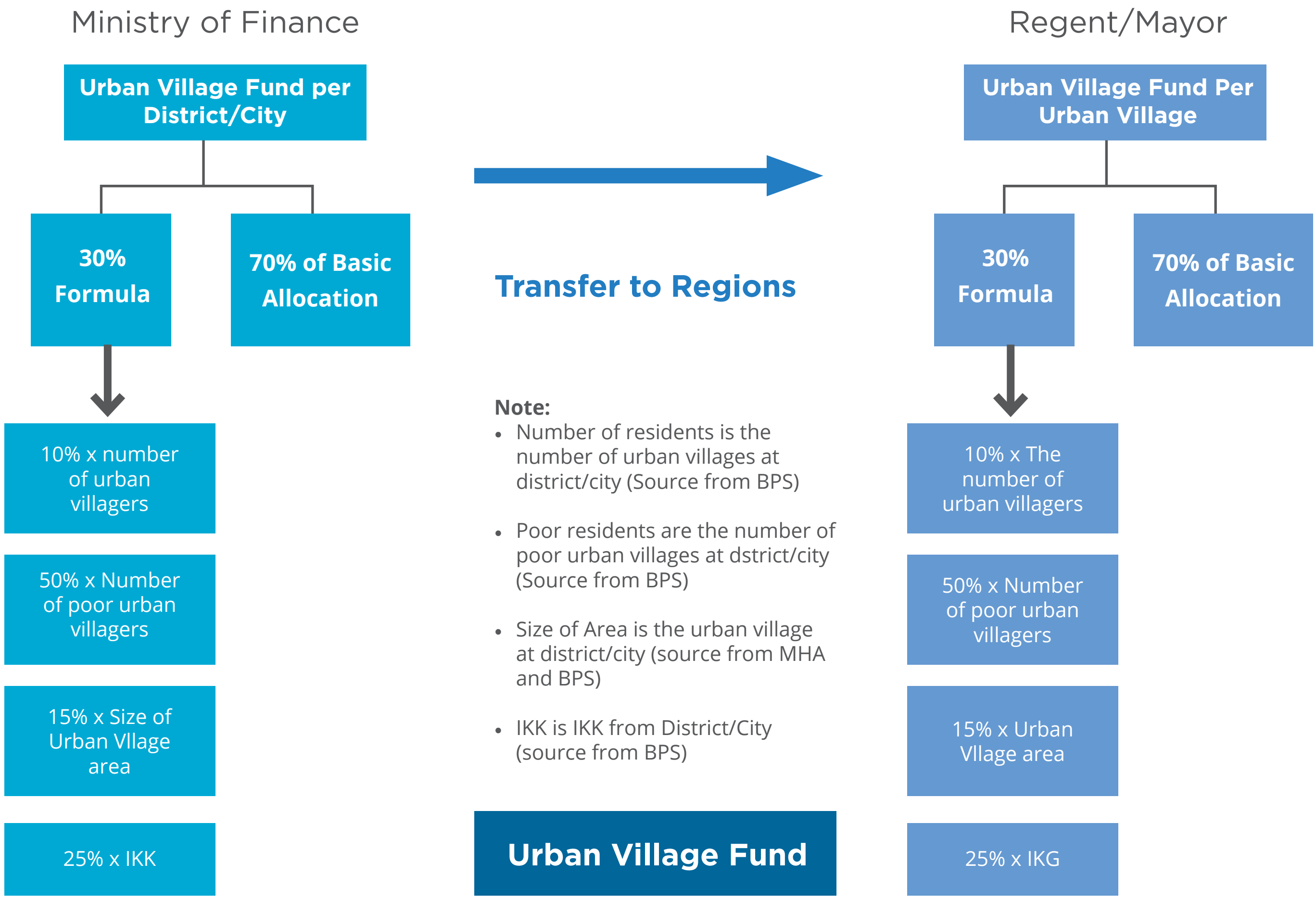
In Scenario 3, the DK allocation for each district/ municipality and urban village consists of the AD and AF. The IKG is used rather than the IKK as the multiplier factor for other indicators when determining the AF.

Under Scenario 4, the DK allocation for each district/ municipality and urban village is distributed evenly based on the number of urban villages in Indonesia.

DK Distribution Flow Proposal

In principle, the Village Fund allocation is sourced from the central government via the APBN. These funds are distributed through the district that then allocates the funds in their APBD (Figure 4). This local government will then disburse the funds to the villages under their authority. In contrast, urban villages receive the funds directly from the municipality government as stated within the APBD. DK allocations will be made under the DAU post, so as to include them within the APBD.

Figure 4: DK Distribution Flow Proposal



DK Utilisation Priority Proposal

The condition of infrastructure in urban villages (kelurahan) is relatively better than that in villages (desa), so it needs to be more directed to increase economic-added value. The utilisation of transfer funds aims to improve human development and increase incomes.

The allocation of funds for community empowerment in urban villages involves community groups/organisations based on a unit cost calculation. The funds for urban village infrastructure use the DAK approach. A weighting needs to be applied in terms of utilisation based on empowerment, facilities, and infrastructure.

Figure 5: DK Utilisation Priority Proposal

DEVELOPMENT OF FACILITIES AND INFRASTRUCTURE

- Roads and bridges
- Housing and settlement
- Sanitation
- Clean water
- Basic health services
- Posyandu
- Early childhood education & Play Group
- Local market
- Environment preservation
- Infrastructure to prevent flood
- Development of regional information system
- Primary health services
- Connectivity facility
- Other facilities based on cash-for-work

COMMUNITY EMPOWERMENT

- Improving cooperation between urban villages/ villages
- Improving partnership between urban village and third party
- Improving empowerment related to family planning
- Improving empowerment related to environment preservation
- Improving empowerment related to preparedness and management of natural disaster in cities
- Other community empowerment activities

PRODUCTIVE ECONOMY

- Improving MSM and cooperative business capacity
- Providing capital aid from MSMs
- Providing support to manage economic business
- Providing support to develop production skill
- Providing support in marketing
- Providing primary needs goods price control through market operation
- Other productive economyicactivities

As mandated by Government Regulation No. 17/2018, determining urban village facilities and infrastructure development activities and community empowerment is done through a community-based consultation and decision-making process known as *musyawarah*. Implementing the budget for the development of urban village facilities and infrastructure and community empowerment should involve community organisations/ groups.

The implementation of Government Regulation No. 17/2018 should consider the urban village needs, so the central government needs to map basic service needs at the urban village level. Determining a menu of activity priorities at the urban village level is based on the quality and quantity of primary facilities and infrastructure (supply-side), therefore, the composite index can be one of the alternative instruments to maintain the DAK on course to achieve the objectives. Priority activities in the use of the DK is flexible but remains focused on the need to solve problems in the regions.

One of the possible examples of DK utilisation is through the cash-for-work policy program. This program is often implemented for activities that require a lot of manpower such as activities under the National Community Empowerment Program (Program Nasional Pemberdayaan Masyarakat: PNPM) in 2007-14. The cash-for-work program is also a current part of Village Fund utilisation activity with the aim of improving village economic activities and reducing the unemployment rate. The cash-for-work program is aligned with suggested priority activities as each urban village has problems with different priorities. The total value of the cash-for-work program is equal to the poverty line or any other reference level applied in each region.

Recommendation

The most optimal implementation target is equal to the Village Fund formulation that upholds the principles of equality and fairness. It is, therefore, necessary to develop a composite index prior to the distribution of allocations during fiscal year 2019. The composite index should also reflect the region's condition, as is the case with the Village Fund with the development of the IKG. This composite index is required as the basis for calculating each region's allocation which can differ from one region to another.

There is a need to align the application of Article 30, Paragraph 8 in the allocation of the DK so it is equivalent to the smallest Village Fund. This is done because the smallest nationwide Village Fund in fiscal year 2018 was Rp 624.69 million, however, the number can vary between regions. With a total allocation of only Rp 3 trillion, it is estimated that the Article cannot be fulfilled. Assuming that the total DK allocation is Rp 3 trillion and that it will be divided equally between 8,479 urban villages, the average allocation per urban village is Rp 353 million. In addition, application of the minimum limit needs to be done in stages in accordance with each region's financial capability. This is based on the consideration that applying this minimum limit has the potential to add further burden to regional finances.

The DK should be distributed based on the composite index as it is applied in the DD by continuing to consider the principle of fairness and taking into account different development needs between regions when allocating the fund. This principle should then be translated into the AF.

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The policy brief ***"Urban Village Fund (Dana Kelurahan) Allocation, Formulation, and Utilisation"*** is written by Hendratno Tuhiman, Priadi Asmanto and Ardi Adji , Research Unit TNP2K.

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THE NATIONAL TEAM FOR THE ACCELERATION OF POVERTY REDUCTION
Grand Kebon Sirih Floor 4,
Jl. Kebon Sirih Raya No.35
Jakarta Pusat, 10110
T: (021) 3912812

www.tnp2k.go.id